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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1994

CITIZENS BANK OF MARYLAND,
Petitioner,
vs.
DAVID STRUMPF,
Respondent.

BRIEF OF BANKAMERICA CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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INTEREST OF THE AMICUS CURIAE

BankAmerica Corporation ("Amicus") is a bank holding company which, through its subsidiaries, transacts banking business on a national basis. Amicus currently operates banks which provide deposit account services in 13 states. With the recent passage of legislation which virtually lifts restrictions on interstate banking, Amicus expects that multi-state deposit account services will be offered by an ever greater number of national banks. Amicus therefore has a great stake in insuring that the Federal Bankruptcy Law is correctly and uniformly interpreted throughout the United States.

Pursuant to Rule 37.2 this brief is submitted prior to the consideration of the Petition for Writ of Certiorari with the

written consent of the parties, as evidenced by the correspondence appended to the brief.

The judgment of the United States Court of Appeals for the Fourth Circuit is manifestly incorrect. If the Fourth Circuit's judgment is allowed to remain the law, Amicus and deposit takers in the Fourth Circuit will be required to forego statutorily granted property rights without hearing or other due process of law in order to avoid liability for contempt. This result conflicts with constitutional principles and the Bankruptcy Code itself.

Because of the substantial impact on the banking community that this case creates, Amicus believes that its views on the proper interpretation of the law may be of assistance to the Court's consideration of this case.

INTRODUCTION AND SUMMARY OF ARGUMENT

The United States Court of Appeals for the Fourth Circuit has effectively stood the Bankruptcy Code[1] on its head by misinterpreting a procedural device so as to invalidate a substantive property right. The Fourth Circuit mistakenly found a depository bank's administrative hold on a bankruptcy debtor's demand deposit account "tantamount to the exercise of a right of setoff" and thus in violation of the automatic stay of § 362(a)(7). *In re Strumpf*, 37 F. 3d 155, 158 (4th Cir. 1994). The effect of the Fourth Circuit's error is to deny banks and other depository institutions a substantive property right without notice or opportunity to be heard, thereby denying due process of law as guaranteed under the Fifth Amendment to the United States Constitution.

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[1]The United States Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*, referred to hereafter as the Bankruptcy Code. All statutory references are to the Bankruptcy Code unless otherwise indicated.

Such was not the intention of the drafters of the Bankruptcy Code. To the contrary, the drafters established a careful balance of rights and duties which ensure that before substantive property rights can be impaired, the parties must be afforded a hearing and adequate safeguards to protect their property interests.

It is essential to keep two incontrovertible concepts firmly at hand. First, a demand deposit account is merely a payable on the books of the depository, not a discrete fund of a depositor's money held in trust. *Keller v. Fredericktown Sav. Inst.*, 66 A. 2d 924, 925 (Md. 1949); *Gordon, Feinblatt, Rothman, Hoffberger & Hollander v. Gerhold*, 608 A. 2d 1194, 1201 (Md. App. 1992). Second, the Bankruptcy Code makes no distinction between the setoff rights of a depository and those of any other creditor. Rather, it is the courts which have created unwarranted distinctions between classes of creditors holding setoff rights.

The issue of setoff is perhaps most focused with depositories due to the ease with which demand deposit accounts are accessed. Unique among creditors who may assert setoff rights, the depository is faced with an immediate demand for turnover of funds through the presentation of a draft or check by the debtor. The depository must then either honor the check, thereby losing the right to setoff mutual obligations, or dishonor the check and preserve such rights. If the second course is chosen the depository "freezes" or holds the account. This administrative hold properly should not be viewed as an act but as a refusal to act in the face of an unlawful attempt by the debtor to withdraw funds.

The Fourth Circuit's opinion creates a false dilemma, *i.e.*, whether an administrative hold imposed to preserve the right of setoff recognized by § 553(a) violates the automatic stay against setoffs accorded to the debtor under § 362(a)(7). This dilemma is false because it has an explicit statutory answer found at § 542(b), a provision rele-

gated to a mere footnote in the Fourth Circuit's opinion. *Strumpf*, 37 F. 3d at 157, fn.*

Amicus will demonstrate that the language of the Bankruptcy Code — together with general principles of statutory interpretation — establish beyond any doubt that Congress did not intend to deny banks and other depository institutions the substantive right of setoff without the due process safeguards mandated by the Fifth Amendment to the Constitution.

The statutory analysis must begin at § 553(a), which specifically preserves the right of a creditor to offset a mutual debt, subject to the limitations therein contained. This substantive right protected by § 553(a) must then be tested by its companion provisions found at §§ 506(a), 542(b), 362(a)(7) and 363(e). This framework of statutory rights and obligations balances the rights of debtors and depositories and accords due process to all.

ARGUMENT

THE FOURTH CIRCUIT'S INTERPRETATION OF § 362(a)(7) OF THE BANKRUPTCY CODE RESULTS IN A TAKING OF PROPERTY WITHOUT CONSTITUTIONALLY PROTECTED DUE PROCESS OF LAW

The Fourth Circuit has interpreted § 362(a)(7) to prohibit an "administrative freeze" which has as its purpose the preservation of the right of setoff recognized by § 553(a). It is respectfully submitted that the Fourth Circuit erred in its interpretation, with the result that Petitioner was denied its property without hearing and without due process of law.

Section 553(a) provides, in relevant part, as follows:

> Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . . .

Section 553(a) recognizes the right of setoff. Section 506(a) goes further. Section 506(a) accords the status of a secured creditor to a party holding rights of setoff, to the extent of the amount subject to setoff.[2] The legal effect of such status is that the property subject to the setoff cannot be used, sold or leased unless the Court, with or without a hearing, determines that such property interest is adequately protected.[3]

Thus, until a debtor accords the holder of setoff rights adequate protection of its rights, the debtor may not lawfully use the property absent the consent of such party. This does not mean, however, that the party holding setoff rights may enforce them. The automatic stay of § 362(a)(7) acts as a counterbalance, and restrains setoff until the Court grants relief from stay to effect the setoff.

The Fourth Circuit balanced § 553 against § 362 and erroneously ruled that the stay against setoff compelled

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[2]Section 506(a), as relevant, provides:

> An allowed claim of a creditor . . . that is subject to setoff under section 553 of this title, is a secured claim . . . to the extent of the amount subject to setoff . . . and is an unsecured claim to the extent that . . . the amount so subject to setoff is less than the amount of such allowed claim.

[3]Section 363(e), as relevant, provides:

> Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest.

Petitioner to turn over the funds in debtor-Respondent's checking account to Respondent, thereby destroying Petitioner's setoff rights, on pain of contempt. Thus, in effect, the stay provision was used to trump Petitioner's substantive setoff rights, and allowed Respondent access to funds which it was legally unable to use without affording adequate protection.

A. THE FOURTH CIRCUIT'S INTERPRETATION VIOLATES THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT TO THE CONSTITUTION

The Fifth Amendment declares that no person shall be "deprived of life, liberty, or property, without due process of law . . . ." The Fourth Circuit's opinion creates a violation of this principle.

This Court is constrained to interpret the Bankruptcy Code so as to uphold its constitutionality. In *Edward J. DeBartolo Corp. v. Florida Gulf Coast Building and Construction Trades Council*, 485 U.S. 568, 575, 108 S. Ct. 1392, 99 L. Ed. 2d 645 (1988), this Court reaffirmed that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." The *DeBartolo* Court characterized this tenet of statutory construction as a "cardinal principle," which "has for so long been applied by this Court that it is beyond debate." *Id.* *See also United States v. Monsanto*, 491 U. S. 600, 611, 109 S. Ct. 2657, 105 L. Ed. 2d 512 (1989); *NLRB v. Catholic Bishop of Chicago*, 440 U. S. 490, 500, 99 S. Ct. 1313, 86 L. Ed. 2d 533 (1979). In defiance of this "cardinal principle," the Fourth Circuit construed the Bankruptcy Code so as to create a violation of the Fifth Amendment.

The Fourth Circuit could have avoided the Fifth Amendment issue entirely by considering § 542(b), which provides:

> Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, *except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.* (emphasis supplied).

Instead, the Fourth Circuit's opinion simply ignores the provisions of § 542(b) to reach its erroneous result. However, were the Bankruptcy Code to be interpreted to eviscerate the right of setoff, it would constitute a taking prohibited by the Fifth Amendment.

This Court addressed the interplay between the Bankruptcy Code and the Fifth Amendment in the case of *U. S. v. Security Industrial Bank*, 459 U. S. 70, 103 S. Ct. 407, 74 L. Ed. 2d 235 (1982), in which the Court held that the Bankruptcy Code cannot be construed so as to destroy the property rights of secured creditors. The holder of a setoff right recognized by § 553 of the Bankruptcy Code is accorded the legal status of a secured creditor and holds a secured claim to the extent of the amount subject to setoff. *See* § 506(a); *Matter of Lawndale Steel Co.*, 155 Bankr. 990, 992 (Bkrtcy. N.D. Ill. 1993). The issue in *Security Industrial* was whether § 522(f) of the Bankruptcy Code could be applied to allow a debtor to avoid a non-purchase money, non-possessory security interest in personal property pre-existing the effective date of the Bankruptcy Code. In order to prevent a taking under the Fifth Amendment, the Court declined to apply this statute retrospectively. In the course of its discussion, the Court examined the relationship between the bankruptcy statutes and the Fifth Amendment, and noted that if a bankruptcy statute destroys property

rights, the statute cannot be defended on "rational basis" grounds:

> It may be readily agreed that § 522(f)(2) is a rational exercise of Congress' authority under Article I, Section 8, Clause 4, and that this authority has been regularly construed to authorize the retrospective impairment of contractual obligations .... Such agreement does not, however, obviate the additional difficulty that arises when that power is sought to be used to defeat traditional property interests. The bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation .... Thus, however "rational" the exercise of the bankruptcy power may be, that inquiry is quite separate from the question whether the enactment takes property within the prohibition of the Fifth Amendment. 459 U. S. at 74-75 (citations omitted).

In reaching its decision the Court carefully distinguished between the rights of secured and unsecured creditors, rejecting the argument of the government that a secured party's rights are deserving of no greater protection under the takings clause than traditional contract rights. *Id.* at 75. The Court stated: "However 'bankruptcy principles' may speak to this question, our cases recognize, as did the common law, that the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral." *Id.*

The Court then discussed the cases establishing that the destruction of a lien is a taking. The government had taken the position that the bankruptcy law had simply imposed a general economic regulation which in effect transferred the property interest from a private creditor to a private debtor, and therefore was not a taking because the government had not acquired for itself the property in question. *Id.* at 78, 79.

The Court was unimpressed, finding that the government's argument was a distinction without a difference. The Court refused to countenance the stripping of a secured creditor's lien rights without affording that secured creditor due process of law.

The analysis in *Security Industrial* applies forcefully to the facts of this case. If § 362(a)(7) is so broadly interpreted as to permit a debtor to take and spend funds subject to the right of setoff, and if § 542(b) is ignored, then the right of setoff becomes meaningless as a practical matter. If the insolvent debtor is permitted immediate and unfettered access to its funds, the funds will be irretrievably dissipated and the bank's property rights as secured creditor will have been destroyed — unconstitutionally taken — by the Bankruptcy Code. *See In re George Ruggiere Chrysler-Plymouth*, 727 F. 2d 1017, 1019 (11th Cir. 1984) ("the Bankruptcy Court cannot allow the secured interest to be threatened by improper use of cash proceeds").

That is precisely what Congress intended to prevent — as a matter of constitutional principle and as a matter of policy — when it enacted the adequate protection standards set forth in § 361:

> The concept [of adequate protection] is derived from the fifth amendment protection of property interests. *See Wright v. Union Central Life Ins. Co.*, 311 U. S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U. S. 555 (1935). It is not intended to be confined strictly to the constitutional protection required, however. The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. *Secured creditors should not be deprived the benefit of their bargain.* ...

H.R. Rep. No. 95-595, 95th Cong., 1st Sess., *reprinted in* U.S.C.C.A.N. 5787, 6295 (emphasis supplied). *See also In*

re Born, 10 Bankr. 43, 48 (Bkrtcy. S.D. Tex. 1981) ("The very heart of the concept of adequate protection is to assure the secured creditor that as the bankruptcy procedures unfold he will not be faced with a decrease in the value of his collateral").

As demonstrated above, there is no reason to reach this conflict between Fifth Amendment and bankruptcy law, because when Congress enacted the Bankruptcy Code it specifically protected setoff rights against such an unconstitutional taking. The view of the Fourth Circuit should be rejected, and the Bankruptcy Code should be interpreted in a manner consistent with the Fifth Amendment.

B. THE FOURTH CIRCUIT'S STATUTORY ANALYSIS IS IN ERROR

The Fourth Circuit characterized the competing mandates of §§ 553 and 362 as the "banker's dilemma" [*Strumpf*, 37 F. 3d at 158] because a banker would be faced with the choice of protecting its property interests by relying on § 553 or being held in contempt by virtue of § 362(a)(7). It is respectfully submitted, however, that this is a false dilemma, created by a misreading of the Bankruptcy Code itself.

In unambiguous statutory language, § 542(b) excuses a turnover of property by one holding setoff rights. This specific statutory language was given no consideration by the Fourth Circuit. In fact, its entire discussion of § 542(b) was relegated to a single footnote with no explanation offered as to why it was not the controlling statutory law. *See Strumpf*, 37 F. 3d at 157 n.*.

Basic principles of statutory construction require courts to interpret statutes in accordance with their plain meaning. "In determining the scope of a statute, we look first to its language. If the statutory language is unambiguous, in the

absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.' " *United States v. Turkette*, 452 U. S. 576, 580, 101 S. Ct. 2524, 69 L. Ed. 2d 246 (1981), *quoting Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U. S. 102, 108, 100 S. Ct. 2051, 64 L. Ed. 2d (1980). The Fourth Circuit should have read and interpreted Section 542(b) to mean what it plainly says.

Instead, by summarily dismissing the clear authority of § 542(b), the Fourth Circuit reached exactly the wrong conclusion. For whatever its reasons, it substituted its views for the Congressional views expressed in § 542(b) despite the plain language of the statute. It read the language of § 362(a)(7), which stays setoff, as mandating a turnover of the funds subject to setoff where no such mandate appears and where the statutory mandate is exactly to the contrary.

As Petitioner makes abundantly clear in its Petition For A Writ of Certiorari, pp. 40 and 41, setoff is a multi-stage process requiring both the intent to setoff and an act which gives meaning to that intent. Recognizing this, the drafters of the Bankruptcy Code balanced the automatic stay provisions against the turnover statutes to preserve the *status quo* and the property rights of the depository until a hearing could be conducted. The Fourth Circuit chose to ignore the statutory framework governing preservation of setoffs in § 542(b), thereby reaching the remarkable proposition that Petitioner's *compliance* with § 542(b) resulted in a *violation* of § 362(a)(7) and subjected Petitioner to contempt and sanctions. This Court should return the law of the Fourth Circuit to the uniform federal bankruptcy law enacted by Congress by giving effect to the plain meaning of the Bankruptcy Code's provisions.

CONCLUSION

Banks and other depositories are not the only creditors who hold rights of setoff recognized by the Bankruptcy Code, but they are uniquely affected by the Fourth Circuit's ruling. Other creditors who may have rights of setoff are not required by the Fourth Circuit's opinion to forfeit their rights in order to avoid contempt. *The opinion appears to apply only to deposit accounts.*

A debtor will attempt to access funds in a bank account merely by presenting a check or other instrument to the bank, making the issue an immediate one. This ease of access makes the issue one of great concern to the banking industry and, perhaps unavoidably, has led courts astray in their analysis of the respective rights and obligations of the debtor and the depository.

There is no good solution other than the statutory solution afforded by § 542(b). In order to protect its rights the bank or other depository should be able to place an administrative freeze on the funds, which will preserve the *status quo*. The debtor will be allowed the opportunity to seek lawful use of the funds under § 363, and the depository will be able to seek relief from stay under § 362. In this manner the constitutional and economic rights of the parties are protected and uniformity in banking practices is assured. For the foregoing reasons Amicus urges that this Court accept

the Petition For Writ Of Certiorari and reverse the decision of the Fourth Circuit.

Respectfully Submitted

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Re: Citizens Bank of Maryland, Petitioner
v. David Strumpf, Respondent
Case No.: 94-1340 (Pending in the
Supreme Court of the United States)

Dear Harold:

I am writing to confirm that our client in the above-referenced proceeding, Petitioner, Citizens Bank of Maryland, consents to the filing by the Bank of America (and/or any of its affiliates) of an amicus brief supporting the Petition for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit filed by us in the Supreme Court of the United States on behalf of our client on February 6, 1995. To the extent necessary, you may consider this consent as having been provided directly by counsel of record on behalf of Citizens Bank, James R. Eyler.

Please let me know if you need anything further from me in connection with this letter.

Very truly yours,

Jefferson V. Wright

JVW/cr
cc: Daniel L. Rhoads, Esq.
James R. Eyler, Esq.

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March 1, 1995

Harold Lichterman, Esquire
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San Francisco, CA 94104

re: Citizens Bank v. Strumpf

Dear Mr. Lichterman:

To the extent that I may pending my admittance to the Supreme Court Bar I consent to your filing, on behalf of your client, an amicus brief in support of the Petition for Writ of Certiorari.

Thank you for your interest in this matter.

Yours truly,

John R. Owen, Jr.

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March 1, 1995

Harold Lichterman, Esquire via fax (415) 622-8399
555 California St.
San Francisco, CA 94104

re: Citizens Bank v. Strumpf

Dear Mr. Lichterman:

I have misplaced your phone number. Mr. Culver provided me your address and fax number.

After much thought and consideration, I have decided to consent to your filing an amicus brief on behalf of your client in support of the Petition for Certiorari.

I apologize for any inconvenience this change may have caused.

With this fax I have enclosed a copy of my consent, on my letterhead, that I have mailed to you today by first class mail. If you wish this done another way, please give me call.

I look forward to meeting you when you come to Washington.

Yours truly,

John R. Owen, Jr.